# THE NATIONALIZATION OF CENTRAL BANKS, WITH PARTICULAR REFERENCE TO DEVELOPMENTS IN CANADA, ENGLAND, FRANCE AND THE UNITED STATES

BY
WILLIAM EDWARD ALLEY
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SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
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ECONOMICS IN THE GRADUATE SCHOOL OF
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# THE NATIONALIZATION OF CENTRAL BANKS, WITH PARTICULAR REFERENCE TO DEVELOPMENTS IN CANADA, ENGLAND, FRANCE AND THE UNITED STATES

The economic chaos following the close of the World War provided the background for as well as the major motivating force in the decade most prolific in the organization of central banks since the establishment of the Bank of Sweden in 1656. No less than eleven central banking institutions came into existence in the decade of the 1920's—eight in central and eastern Europe, two in South America and one in South Africa. To this number may be added the reorganizations of the Commonwealth Bank of Australia in 1924 and the German Reichsbank under the Dawes Plan.

The decade of the 1920's was not only a significant one because of the number of new central banks organized but also because of the great degree of independence granted to such institutions. Independence from direct governmental control came to be accepted in orthodox economic circles as a necessary requisite to sound central banking. Under the influence of the League of Nations and the Bank of England protection of the central bank from government control was a prominent element in the constitution of most of the newly organized central banks.

The experience gained during the War and the early post-War period was responsible for the movement for greater independence for central banks. During this period the central banks had been under government domination in most countries, assisting their governments in financing the War and the reconstruction through inflationary measures which in some countries brought about the complete breakdown of the currency system. It was the fear of further inflation and the desire to establish sounder currency systems throughout the world that gave emphasis to the need for the separation of

central banking policies from control which is dominated by the current financial needs and political manoeuverings of the government.

Independence, as an attribute of central banks, does not mean that central banks may not or should not co-operate with their respective governments. In time of a national emergency the central bank may have to submit to a policy dominated by the immediate needs of the time and determined by the government. Such a policy may or may not be in harmony with the bank's conception of a sound policy. The bank should, however, give the government the benefit of its advice and experience. The intention of those who propose freedom from government control for central banks is to avoid the use of the bank in normal times for political purposes and as a substitute for a sound fiscal policy. The traditional weakness of governmental control has been the fact that it has invited government borrowing and the manipulation of credit as a substitute for balancing the budget by means of decreasing expenditures, increasing taxes and establishing a generally sound economy.

The wide-spread effects of the depression in the early 1930's taxed the resources and ingenuity of governments throughout the world in their efforts to stay the devastating consequences of the world-wide economic break-down and to bring about the recovery of business activity. The severity of the depression gave rise to many proposals, schemes and panaceas, sound and unsound, for getting out of the depression and avoiding any further recurrence of this economic phenomenon.

In an effort to find the cause as well as a method of attack upon the depression many found both elements contained in their conception of the rôle played by money and credit in the present economimc system. It was maintained that there was a scarcity of money and credit which made it impossible for business activity to be efficiently carried on. The solution to the problem, then, was simple and direct. It consisted in increasing the amount of money and credit by direct action of

the government and the continuation of this action until a satisfactory level of prices and business activity obtained. Such a plan was based upon the complete acceptance of the quantity theory of money in its simplest form. It disregarded completely the great multitude of factors which have an influence, both direct and indirect, upon business activity.

The movement for nationalization of the central bank in Canada, England, France and the United States was a logical consequence of the demand for a more liberal monetary and credit programm. Since the central banking authorities had failed to lead their respective countries out of the depression and had even refused to admit that their power to control credit had more than a mere indirect influence upon business activity and the general price level, it was demanded that the governments take over the control of the central banks and operate them "in the general public interest." "In the general public interest" was interpreted to mean an increase in the general price level which would make possible the paymemnt of debts, the full employment of all employables and, most interesting of all, a stability of the price level such as has never heretofore been known. Only a central bank completely dominated by the government would or could undertake so ambitious a program armed only with the instruments of credit control possessed by central banks. Perhaps, it should be observed that only an institution dominated by the government would seek so simple a solution to so complex a problem.

The term nationalization is capable of several interpretations. It may include the control of the policies of the central bank by the government by direct means as through ownership or through a majority representation on the board of directors or by indirect means as through the influence exerted by the government upon the bank. Since this last is uncertain as to its duration, although no less important at the time, nationalization in this investigation has been interpreted to mean either ownership or legal control of the policies of the bank by government representation on the board of directors.

The four countries included in this study differed among

themselves as to the type and method of nationalization followed or proposed. Canada approached the problem first through the establishment of a privately owned and controlled bank, then a partically publicly owned but publicly controlled bank and, finally, a fully publicly owned and controlled institution. In England, where the movement did not get beyond the proposal stage, public ownership and control was anticipated. The reorganization of the Bank of France in 1936 established a privately owned but publicly controlled institution. The movement in the United States, as in England, was never enacted into law. It early took the form of proposed Congressional control through a mandate which would direct the policies of the Federal Reserve System toward a given goal previously determined by law. In its most recent form nationalization in the United States anticipates government ownership as well as control.

*Canada.*

The changes in the banking system of Canada resulting from nationalization were more significant and perhaps more fundamental than those made or proposed in any of the other countries studied. In the brief span of five years Canada advanced by successive stages first to the establishment of a central bank which was privately owned and controlled; second, to one partially publicly owned but publicly controlled; and, finally, to a publicly owned and controlled institution. The changes made in the banking system of Canada become more significant and representative of the general tenor of the 1930's when it is recalled that the Canadian banking system has for many years been accepted by economists and financial authorities generally as one of the soundest and most efficient in the world.

The agricultural regions in the Canadian West were very hard hit by the depression. This was particularly true of the wheat producing provinces of Alberta, Saskatchewan and Manitoba. Depending for their livelihood upon the vagaries of the climate and the work market for wheat, these regions

suffered a greater decline in economic well-being in 1930-1933 than any other section in the Dominion. Municipal finance in the West reflected the financial difficulties of the surrounding farming regions.

In the agricultural regions of Canada there was a scarcity of credit in the early 30's. Both the farmers and the municipalities suffered from it. It was no doubt natural, if it was not justifiable, that the chartered banks should be held responsible. The real cause for the lack of credit, however, was not the unwillingness of the banks to grant credit so much as it was the lack of any basis for credit which could be presented by those needing financial aid.

The movement for the establishment of a central bank received strong support in the West. It was hoped that a central bank would be in a position to grant credit on easier terms than the chartered banks had been willing to do. In many quarters it was demanded that the bank be owned by the Dominion and used in the operation of a monetary and credit program, centered on the objective of a higher and more stable price level as well as the granting of credit on easy terms.

Among professional economists and government officials the establishment of a central bank was looked upon as a necessary final step in the completion and unification of the Canadian banking system. The system, with all its strength, lacked any agency through which the chartered banks might be brought into unified and harmonious action in the control of credit. Another weakness which many economists found was the lack of any agency through which Canada could co-operate with other countries and the central banks of other countries in any international monetary program. The need for international monetary co-operation was made apparent by the breakdown, temporarily at least, of the gold standard.

The chief opposition to the establishment of a central bank in Canada came from the chartered banks. They resented the implied criticism of their policies contained in the proposal to establish the central bank. They looked with some alarm upon the prospect of having to surrender the note issue privi-

lege to the central bank. Perhaps the most valid criticism leveled at the proposal by the chartered banks was their contention that, lacking a money market in Canada, the success of the central bank in the control of credit would be definitely circumscribed.

It is not so difficult to determine the forces and motives for the establishment of a central bank in Canada as it is to give any adequate explanation for the revisions of the charter of the Bank of Canada in 1936 and 1938 providing first partial and then complete nationalization. Unquestionably party politics was a significant force in these revisions.

At the time of the establishment of the Bank of Canada the Conservatives were in power and succeeded in thwarting the efforts of the Liberals to nationalize the Bank. In the election of 1935 the Liberal Party was successful and the Amendments of 1936 may be explained as the fulfilment of the Party's pledge. The Liberal Minister of Finance, C. A. Dunning, justified the proposed amendments on the grounds that the control of credit and the general price level—two important functions of a central bank—were too important to be left in private hands.

Granting the validity of the reasons advanced by the Minister of Finance, they still fall short of a complete explanation of two facts; one, the Amendment of 1936 provided only partial nationalization—control but only partial ownership; and two, the real reasons for the Amendment of 1938 providing complete public ownership. If control of the policies only of the Bank of Canada was a satisfactory Liberal program in 1936, it is difficult to find any reasons for the Party's shift to complete nationalization in 1938. The Party's financial spokesman, Finance Minister C. A. Dunning, refused to give any explanation other than that it was desirable to end all political controversy regarding the Bank of Canada. The Conservatives in Parliament pointed out, signficantly, that there had been little or no controversy concerning the Bank for a period of two years. Having a sufficient Liberal majority to pass the measure over all opposition, no really plausible expla-

nation was ever given.

The outbreak of the European War in the fall of 1939 which placed Canada on a war basis has made it impossible to examine the Bank of Canada under normal conditions. Had this situation not arisen, it might been been possible to have found in the operations of the Bank the evidences of some plan or procedure which prompted the Government to demand and secure complete nationalization in 1938. This same set of circumstances makes it impossible to determine what the ultimate effect of the operations of a central bank will have upon the Canadian banking system and the Canadian financial economy.

*England.*

While the movement for nationalization of the Bank of England, like similar movements in Canada, France and the United States, was primarily a product of the depression, it was perhaps more definitely associated with a particular political party than in any other country except France. Nationalization in England cannot be dis-associated from the Labor Party. It was essentially a Labor Party program and received by far the greater part of its support from that Party.

The Labor Party in England during the period covered in this discussion was admittedly a socialist party. As early as 1926 the Labor Party adopted a proposal for the nationalization of the Bank of England as a part of a general program of socialization. In its early proposals the Labor Party supported nationalization of the Bank because of a conviction that through its control of credit the Bank was able to dominate the course and to determine the success of the nation's business. It was essential to any general scheme of socialization that such an important element in the nation's economic life should be publicly owned and controlled.

The Labor Party directed its early criticism at the Bank of England against its influence in bringing about the return to the gold standard in 1925. They felt that the action was premature since English industry had not made a satisfactory recovery from the effects of the World War; prices in England

were higher than those of England's competitors for world markets; and English exports were gradually losing ground. Unemployment was high in England and benefits to the unemployed were a heavy burden upon the budget. From March 1925 to March 1930 the Bank maintained its discount rate at between 4 and 6 per cent for the purposes of protecting its gold and strengthening sterling in the international money market. The policy of the Bank was branded by the Labor Party as deflationary, and they declared that it was maintained for the benefit of the financial interests rather than for the encouragement of and service to business and commerce.

When the Labor Party came to power in 1929, it did nothing to bring about the nationalization of the Bank of England. The failure of the Labor Party to successfully meet the financial crisis of 1931 resulted in the establishment of a National Government under the leadership of J. Ramsay MacDonald, a former leader in the Labor Party, and the Labor Party's almost complete loss of influence in Parliament as a consequence of the general election of October, 1931.

Following the fall of the Labor Government, the Labor Party increased the intensity of its attacks upon the Bank of England and the financial interests of the country generally. These were charged with responsibility for the fall of the Labor Government because of their attempts to determine its financial policies. In the Party's annual conventions in 1931 and 1932 the immediate establishment of public ownership and control of the Bank of England was demanded. In 1933 the program was extended to include ownership and control of the "Big Five" joint stock banks by a public corporation. It was expected that these institutions, after having been converted into public owned and controlled institutions, would work in conjunction with a National Investment Board charged with responsibility for directing the flow of credit and investment funds into public and private channels where, from a social point of view, they were most needed.

The demand for nationalization of the Bank of England declined materially as the country experienced considerable

economic recovery from 1934 on to the outbreak of the present war. The Bank of England, no doubt working in harmony with the Government, pursued a policy of providing easy credit. Business activity increased; the exports of the country made considerable recovery; and the Government was able in 1934 to balance its budget.

The nationalization movement in England is not dead. The Labor Party, although somewhat discredited by its failure in 1931, still supports the conviction that it should be accomplished. The Labor Party, as a socialist party, is a minority party of protest. It may return to power at any time. Given a national economic crisis and the Labor Party may again receive sufficient support as a protest vote as it did in 1929 to return it to power. In such an eventuality the movement may again become a major issue in England.

*France.*

Nationalization of the Bank of France may be traced to the budgetary difficulties of the Flandin Government in the spring of 1935. The Bank demanded that the budget be balanced by the reduction of expenditures for civil servants, pensioners and rentiers. Upon Flandin's refusal to meet these demands, the Bank restricted its advances to the Treasury and maintained a low discount rate which permitted a heavy drainage of gold from France and threatened to weaken the franc. Finally the Government was forced to give in but only after a struggle which placed the Laval Government in power.

The economies instituted by Laval served to kindle the flame of opposition to the Bank. French economic opinion was divided into two groups, i.e., those favoring inflationary public expenditures and those favoring deflationary balancing of the budget. Since the "200 Families" controlling the Bank of France were also the leaders in industry and commerce, the Bank came to be looked upon as the stronghold of deflationary conservatism.

The rise of the Popular Front, composed of all leftists groups, after the Stavinsky scandal and the February Riots in

1934, coupled with a rapid increase in fascism in France about the same time, brought the opposition to the Bank into the open and gave it the backing of the organized Popular Front. The evidence that the Bank of France supported the fascists is only circumstantial. The Bank favored curtailment of expenditures and a conservative policy generally. Opposing, as it did, the program of the Popular Front automatically linked it in the minds of the leftists with the fascists who also opposed the Popular Front. There was some evidence that Doumergue and Laval, both holding favor with the Bank, also held favor with Coloenl de la Roque.

The success of the Popular Front in the election in the spring of 1936 sealed the doom of the independence of the Bank of France. Early in the summer the Blum Government secured such revision of the Constitution of the Bank as was necessary to secure absolute assurance of control by the Government.

Prior to the outbreak of the present war, the only tangible evidence of any effect of the new relations between the Government and the Bank was the disappearance of the Bank's opposition to a program of vast public expenditures and the signing of conventions whereby the Bank agreed to increase advances to the Treasury. From June, 1936 to September, 1938 these advances increased from 14,333 million francs to 50,134 million francs or about 250 per cent. Any attempt to draw conclusions as to the future relations between the Bank and the Government is forestalled by the fact that France is now a conquered country and the Bank of France itself has been taken over by the conqueror. The future of the Bank must depend upon the outcome of the present struggle.

*The United States.*

The proposals for nationalization of the Federal Reserve banks, while springing from the same general causes as in Canada, England and France, differed from the movement in those countries in that it emphasized the need for raising the general price level as almost the sole purpose of nationalization. This plan for raising the general price level was based

upon a conviction that the general price level was determined almost exclusively by the quantity of money in circulation. Business activity was in turn determined by the height of the general price level. Hence, the belief that by monetary action, i.e., increasing the amount of currency and credit, it was possible to bring about the return of prosperity.

The proponents of nationalization in the United States entertained the naive belief that monetry authorities could, without inflation, by increasing the quantity of money and credit alone raise and maintain general prices and business activity at any desired level. All factors of psychology, climatic conditions, crop failures, political conditions, wars and other factors which are so important in determining the course of business were ruled out or made possible of positive counteraction by monetary policy.

The Goldsborough Bill of 1932 was a direct reflection of this point of view. It attempted to give Congress the power to issue a mandate to the Federal Reserve Board to raise prices to the 1926 level and then to maintain stability. The sole means available to the Board for performing so vast a task was its control over credit.

The proponents of the Goldsborough Bill were found chiefly among the farmers and debtors classes and the organizations and Congressmen representing them. Among the chief opponents of the measure were most of the leading economists of the country, the leading bankers, Federal Reserve officials and Government officials.

The opposition denied the validity of so literal an application of the quantity theory of money; it denied that the Board possessed the power to force money and credit into circulation; and it maintained that there was no justification for the assumption that 1926 or any other year represented a point where stability was desirable. In fact, stability as anticipated by the proponents of the measure would impede, if not completely stop, progress.

The Goldsborough Bill was passed in the House but failed in the Senate where a substitute measure was passed which

completely destroyed its meaning and purpose.

The failure of the efforts of the Roosevelt Administration to raise prices as rapidly as was desired through the purchase of gold, the devaluation of the dollar and the purchase of silver, coupled with the "recession" of business activity in 1937 and 1938, raised again the question of nationalization. By placing much of the responsibility for the "recession" upon the Federal Reserve Board for having increased reserve requirements in 1936 and 1937, the proponents of nationalization were able to justify, to their own satisfaction at least, a new proposal for nationalization.

The Pattman Bill introduced in Congress in the spring of 1937, differed from the Goldsborough Bill in that it proposed to transfer the ownership of the Federal Reserve banks to the Government. An amendment later attached to the measure a mandate similar to that contained in the Goldsborough Bill.

The arguments pro and con for the Patman Bill followed the same general pattern as those for the Goldsborough Bill. Its supporters and opponents may be found among the same interests. The major question then, as in the case of the Goldsborough Bill, was whether the Federal Reserve Board could and should, by the use of monetary measures alone, raise and stabilize the general price level.

Although the Patman Bill failed to be reported out of the Committee on Banking and Currency, its supporters have never permitted the issue to die out completely. In each session of Congress a bill has been proposed by Congressman Patman embodying the principles of his original bill. In January, 1941, a similar measure was introduced by Congressman Voorhis of California. At the present time the rapidly raising price level, the increase in employment and the expansion of business activity resulting from the defense program has made the purposes of such measures as the Goldsborough Bill and the Patman Bill seem unnecessary. Hence the possibility of any immediate action being taken to nationalize the Federal Reserve System seem very remote.

*Conclusion.*

The period covered in this thesis has been far from "normal." This fact alone makes it very difficult to detect any positive trends in regard to nationalization. This is a difficulty which cannot be avoided since nationalization is itself a product of the economic maladjustments of the late 1920's and the 1930's. No sooner had the World begun to return to something like normal economic activity than it was plunged into what seems to be destined to be the most destructive war in all history.

One thing stands out as a result of this investigation. That is the fact that the dissatisfaction of the people with their monetary and banking system is in considerable evidence only in times of economic distress. Since economic distress to the man-on-the-street is most clearly indicated to him by a scarcity of money in his pocket, or deposits at the bank, he naturally and logically confuses cause and effect and attributes his economic distress to a scarcity of money. This man can understand the fact that because he has no money he has no purchasing power. That is evident to him. What he fails to understand is the fact that money arises out of business transactions and is, except where there is an inflationary psychology, business-determined and not business-determining.

The power of a central bank to control prices and business activity is limited largely to indirect action and influence. The central bank can facilitate business by making money and credit available where and when it is needed. It can in some cases influence business by directing the use made of its credit facilities. It would be impossible for the central bank, by monetary means alone, to control the course of prices and business. Its influence is only one of a multitude of factors each of which plays a greater or lesser part in determining the state of prices and business at any given time.

What of the future of nationalization? The possibilities for further demands for nationalization of the central banks in England and the United States, where it has not yet become an accomplished fact, are very great. In the United States,

particularly, there seems to have been developing in the last decade a psychology of expecting the Government to assume a greater direct responsibility for the general welfare. The present Administration has seemed to favor monetary means in a large degree for increasing the economic welfare, although it has not as yet given its support to the idea of nationalization of the Federal Reserve System.

The magnitude of the present war with the destruction of billions of dollars worth of property, the unprecedented increasing public debts and taxes, and the destruction of life, both civilian and military, cannot but foreshadow great economic distress for many many years to come. It is impossible at tthis time to anticipate the magnitude of the problems that will demand solution in the near future. It can be stated that they will undoubtedly tax the resources of every country in the World to the utmost. Co-operation, both national and international, will be demanded by the situation.

In such a set of circumstances as can be reasonably anticipated in the future, it is neither impossible nor improbable that resort may be had to monetary measures which can be attained onl yby depriving the central banks of such independence of action as they may still possess. The future of nationalization may depend upon the serevity of the problems to be met but probably more upon the statesmanship available with which to meet them.

## VITA

William Edward Alley was born at Geneva, Indiana, March 27, 1903. After receiving his elementary and secondary school education in the schools of Decatur County, Indiana, he matriculated at De Pauw University in September, 1922. He received a Bachelor of Arts degree with honors from that institution in June, 1926. Subsequent to his graduation he taught in the secondary schools at McLeansboro, Illinois (1926-1928), Burney, Indiana (1928-1931) and Urbana, Illinois (1931-1936). Since October 1, 1936 he has been employed as an instructor in Commerce at Grove City College, Grove City, Pennsylvania. He entered the Graduate School of the University of Illinois and received the Master of Arts degree in Economics in August, 1932. Since then he has been engaged in fulfilling the requirements for the degree of Doctor of Philosophy of which this thesis is a part.